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FAMILY ARRANGEMENTS, CONSTRUCTIVE TRUSTS AND THE HOME OWNERSHIP SCHEME



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In two recent cases heard together by the Court of Final Appeal, the court held that a trust arising from contributions to the costs of purchase of a Home Ownership Scheme flat is not an assignment or alienation rendered void by s 17B of the Housing Ordinance. This is a sensible and pragmatic conclusion where contributions from family or friends of the purchaser are concerned and can be justified by a purposive interpretation of the section. However, the court may have gone too far in its reasoning and opened up a route for commercial exploitation by which those very purposes will be undermined.

Introduction

The Hong Kong Government's Home Ownership Scheme (HOS) has proved an effective and popular means of promoting private ownership of property. Since inception in 1978, the scheme has enabled some 350,000 families to become home owners. The HOS was one of the drivers of the increase in the rate of home ownership amongst householders from 29 per cent in 1982 to 53 per cent in 2002, a rate which has held broadly steady since then. During the first three decades of the scheme's operation, on average more than 22,000 flats have been sold under it each year.¹

The idea behind the HOS was to give the less affluent an opportunity to buy their own home despite Hong Kong's perennially high property prices and thereby improve their standard of living and allow them to share in the general prosperity. The scheme aimed to promote home ownership by providing domestic flats for sale to qualifying members of the public at a concessionary price. The underlying objectives were to

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¹ Marco Woo Moon hoi, vice-chairman (now chairman), Hong Kong Housing Society, "To Be or Not To Be – The Resumption of the Home Ownership Scheme", Speech and Powerpoint Presentation to the Business and Professional Foundation of Hong Kong, 4 June 2011.

enhance social stability by inculcating a sense of belonging, by improving the quality of living and by promoting formation of assets.

The main beneficiaries of the scheme were intended to be lower middle-income households and better-off public housing tenants. Applicants and those who would occupy the HOS flat with them had to have a combined income which was below a prescribed limit. The government subsidised the land costs of HOS projects, enabling the flats to be sold at a discount (typically 55–70 per cent of the market value) with a down-payment of 5 or 10 per cent of the price, and arranged favourable terms of mortgage from approved lenders for buyers.

Despite their modest means, those who were qualified to buy needed no persuasion as to the attractions of the scheme: from the first sale of HOS flats in 1980, demand exceeded supply. Ballots had to be held in order to select who would be allowed to buy. Families would pool their resources in order to meet the deposit, acquisition costs and mortgage repayments. Different members of the family would make an application in the hope that one of them at least would be successful in the ballot.

When the administration sought to revive the private housing market in 2002, one of the more effective of a bundle of measures that was introduced was the suspension of the HOS. When the administration sought to quell the exuberant market ten years later, one of the steps taken was to resume the HOS. The latest phase of the scheme appears to be as popular as its predecessors.

Restrictions on Alienation

Since the objects of the HOS are to promote ownership and provide housing, not to facilitate profit, from the outset the scheme's terms of sale have restricted alienation by purchasers. The HOS forbids purchasers from alienating their flats to anyone but the Housing Authority or those who already enjoy low-cost housing (essentially tenants of the Housing Authority) for a number of years following assignment of the flat to them and requires that if the purchaser does sell the flat, a premium be paid to the Housing Authority based upon the increase in the prevailing market value of the flat during the purchaser's period of ownership of the flat.

Generally, owners can resell HOS flats only with permission of the Housing Authority (which administers the scheme) and after five years from the first assignment of the flat by the Authority.² This restriction is

² The restriction period was originally 10 years, but this was reduced to 5 years in 1999. After 3 years, owners can apply for permission to sell to other low-income Hong Kong residents.

contained in the schedule to the Housing Ordinance (Cap 283), and, by virtue of s 17AA of the ordinance, becomes part of the standard terms of sale and purchase and of the assignment of the flat by the Housing Authority to the purchaser.³

These contractual restrictions are reinforced by s 17B of the ordinance which provides that if an HOS flat purchaser purports to mortgage or otherwise charge or to assign or otherwise alienate the flat without permission from the Housing Authority and acts in breach of his agreement with or assignment from the authority, the mortgage, charge, assignment or other alienation shall be void.⁴ Furthermore, s 27A makes it a criminal offence, punishable by fine of up to HK\$500,000 and imprisonment for a maximum period of one year, to purport to make such alienation. The offence is committed not only by the owner (ie the purchaser from the Housing Authority) but also by other parties to the transaction. That would include a lender who takes a mortgage or charge over the flat. This provision is designed to prevent purchasers from borrowing money on the security of the difference between the subsidised purchase price and the market value of the flat.

Hence, the policy pursued by s 17B is that the purchaser of an HOS flat may neither resell it for quick profit nor turn part of the value of the flat quickly into cash by using it to support borrowing.⁵

The Issue

The question common to the two appeals before the Court of Final Appeal (CFA) was as to the scope of the phrase “assign or otherwise alienate” in s 17B(1). Specifically, is the creation of a beneficial interest under a trust of the resulting or constructive sort by payment of part of the purchase price of property an assignment or alienation caught by the subsection?

The Facts

In the first of the two appeals, *Cheuk Shu Yin v Yip So Wan*,⁶ a retired couple from mainland China were registered owners of an HOS flat at Fanling bought for HK\$1,214,000 in 2000. The purchase price had been

³ The terms are stipulated in Sch 4 to the Housing Ordinance (LHK).

⁴ Housing Ordinance, s 17B(1).

⁵ This was articulated by the Secretary for Housing in *Legco* in 1978, as quoted by Lord Hoffmann in *Cheuk Shu Yin v Yip So Wan* (2012) 15 HKCFAR 344, [26].

⁶ *Ibid.*, FACV 9/2011.

paid by their son and his wife. The latter sued for a declaration that she had a beneficial interest in the flat following the death in 2010 of the son from whom she had been divorced in 2006. The trial judge, Fung J, made the declaration but only after alerting the Housing Authority to his intentions and receiving no negative response.

In the second appeal, *Ling Wai Fai Billy v Ling Shui Fai*,⁷ a married couple were the registered owners of an HOS flat bought in 1984 for HK\$225,000 but the husband's mother, Madam Wong, his brother and the brother's wife all claimed to have contributed to the costs of acquisition. Their version of events, which was taken to be true for the purposes of the hearing, was that Madam Wong decided to buy an HOS flat for use by the family and there was an arrangement that she would pay the initial deposit, acquisition expenses and early installments of the mortgage repayments and that those members of the family who occupied the flat would pay the later installments and expenses. To increase the chances of success in the ballot, two applications were made, one in the name of Madam Wong and the other in the names of the couple. The latter were successful but it was the brother and his wife who moved into the flat and made the payments in accordance with the arrangement. However, the couple, as registered owners, made an agreement to sell the flat to a third party in 1997 for HK\$1,200,000. The brother and his wife brought an action seeking a declaration that they were beneficial owners and an order setting aside the sale agreement. The registered owners applied to strike the action out on the basis that the alleged beneficial interest arising from the family arrangement was an alienation which was rendered void by s 17B.

The trial judge, Chu J, held that there was no alienation, reasoning that the arrangement arose by operation of law and did not result from any positive act by the registered owners. The Court of Appeal disagreed: the registered owners had entered into a family arrangement, used the mother's money and allowed the brother and his wife to occupy the flat, acts which amounted to alienation. The appellate judges were concerned that a different conclusion would open the way for abuses of the HOS. They thought that a successful HOS applicant might sell his or her rights to a third party who was willing to make all the necessary payments and thereby acquire a beneficial interest in the property with the prospect of profiting from the increase in capital value of the flat. Consequently, they overturned the Court of First Instance in both this case and, later, in *Cheuk Shu Yin*.

⁷ *Ibid.*, FACV 11/2011.

Further Appeal

Delivering the main judgment in the CFA, Lord Hoffmann NPJ observed that “alienation” was not the most natural way of describing the imposition by equity of a constructive or resulting trust, for the word normally denoted a juridical act performed by someone entitled to an interest in property for the purpose of transferring all or part of that interest to another.⁸ Nevertheless, his lordship accepted that the meaning of alienation depends upon the context in which it is used and the purpose served by the legislation in which it appears.⁹ Lord Hoffmann thought, however, that the holder of an equitable interest in an HOS flat created by funding its purchase would find that realising his investment before the end of the restriction period was impossible: he could not terminate the trust and call for assignment of the legal estate because the assignment would be unlawful under s 17B; he could not ask for an order that the property be sold because the sale would also be unlawful under s 17B; and he could not require that the flat be let for rental income because of the covenant against parting with possession contained in the statutory terms of sale.¹⁰ Permitting a third party who has provided finance for purchase of the flat to realise a profit from an increase in its value during the period from acquisition to resale after expiry of the restriction period would be doing no more than allowing the same degree of speculation enjoyed by the purchaser, Lord Hoffmann suggested. Anyway, his lordship thought that the investment would hardly be attractive: the money would be locked up as an unregistered interest in land, unrealisable and producing no income for a period during which property prices might go down as well as up. So, he concluded, the risk of abuse was rather remote.¹¹

As against this risk, the denial of a remedy to someone who had paid all or part of the purchase price on the understanding that he would acquire a beneficial interest could be unjust, Lord Hoffmann observed. His lordship thought that it was in the public interest that those whose incomes were so low that they were unable to pay the deposit or keep up the mortgage payments should be able to buy a flat with the assistance of family or friends, on the basis that the latter would have beneficial interests which they can realise when the restriction period has expired.¹²

All the other four CFA judges expressed agreement with Lord Hoffmann. Bokhary PJ declared that what had happened in these cases

⁸ *Ibid.*, [24].

⁹ As stated by Keith JA in *Re A Solicitor* [CACV 117/2000](#), [12].

¹⁰ *Cheuk Shu Yin* (n 5 above), [30].

¹¹ *Ibid.*, [31]–[34].

¹² *Ibid.*, [33]–[35].

was not an alienation and agreed with Chan PJ's views.¹³ The latter's view concerning alienation was that there had not been an alienation *by the owner* because the trust arose by operation of law; the type of alienation caught by the legislation was one aimed at quick profit.¹⁴ Chan PJ also expressed agreement with Lord Hoffmann's views which (as will be seen) were wider. Litton NPJ agreed with both Chan PJ and Lord Hoffmann.¹⁵ Ribeiro PJ agreed with Lord Hoffmann.¹⁶

Discussion

The difficulty with the mutual agreement expressed by their lordships of final appeal is that the four judges who gave reasons did not give exactly the same reasons. The judges were certainly unanimous in finding that a family arrangement for pooling resources in order to acquire an HOS flat is not an alienation contemplated by the ordinance and so is not void under s 17B. But they seem to have had different reasons for this conclusion.

No one could sensibly argue that the practice of financing acquisition of property by family contribution is undesirable or to be discouraged. The practice is longstanding and widespread among Chinese people in Hong Kong and is not confined to those of moderate means. It has played a part in the improvement of living conditions over five decades. Furthermore, the rules of the HOS seem obliquely to recognise the practice. As Chan PJ observed, an HOS applicant is required to disclose the persons who would occupy the flat and their total income and assets, which must not exceed a certain limit, and a change of ownership to reflect the contributions of authorised occupants is permitted. A factual distinction can be made between that arrangement and one by which a stranger later advances money and attempts to acquire the flat or an interest in it. But how is the law to recognise the distinction? Both arrangements involve a trust imposed by operation of law and an apparent transfer of property.

One option would have been simply to recognise the factual distinction and say that, on a purposive and contextual interpretation of s 17B, the words were not intended to avoid family arrangements entered into for the purpose of acquiring HOS property by members of the family, so such an arrangement is not an assignment or alienation contemplated by the section. The attraction of this approach is that it minimises the scope

¹³ *Ibid.*, [1].

¹⁴ *Ibid.*, [8].

¹⁵ *Ibid.*, [16].

¹⁶ *Ibid.*, [10].

for avoidance of the effect of the provision. The problem is that if the interpretation stopped there, it would involve some artificiality in that it ignores the interposition of the trust.

Section 17B (1) renders void an alienation by the person to whom the land is sold by the Housing Authority. A constructive or resulting trust is a creation of equity, a legal conclusion drawn from facts. It results from no positive, juridical act by that person. That person will normally have had a role in the facts which give rise to the trust but will not be the only participant. A more satisfying approach therefore would be to say that no constructive or resulting trust of any kind is caught by the subsection because such trusts are not alienations by that person. This approach appealed to Chan PJ.¹⁷

There is a third, even wider, option. This is to say that no trust, including any express trust, is rendered void by the subsection. In other words, trusts of their nature are not alienations even where they are consciously created by the person who owns an HOS flat. This was the preference of Lord Hoffmann. Whilst recognising that assignment or alienation was not a natural description of what happens when a constructive or resulting trust arises by operation of law, he declined to decide the case on this linguistic point. Nor was he prepared to rely on the absence of a juridical act by the owner. Instead, he held that a trust was the creation of a new derivative interest rather than an alienation of an existing interest.¹⁸

The consequence of this wider approach is that any trust, even one created by express declaration, is not an alienation within, and so is not void under, s 17B. The approach opens the way to exploitation by HOS buyers who wish to turn the government subsidy into immediate cash and by those who wish to lend money to such buyers and to invest in or speculate upon the appreciation in value of the flat. A declaration of trust in favour of the lender signed by the buyer at any stage after sale of the property by the Housing Authority would secure an interest in the property; indeed not even that is necessary, just proof of contribution to the purchase price. A deed of trust giving expression to the family arrangement had actually been prepared at one point by solicitors acting for the family purchasers in *Cheuk Shu Yin* but in the event had not been executed. Lord Hoffmann specifically stated that the position would have been no different had that declaration of trust been made.¹⁹ There would still have been no alienation.

¹⁷ *Ibid.*, [8].

¹⁸ *Ibid.*, [24] and [36].

¹⁹ *Ibid.*, [36].

The principle as stated by Lord Hoffmann is not limited to trusts, express or otherwise, created in favour of family members or which are part of a family arrangement. Hence, the way is open to the exploitation of the trust as a device by strangers. Lord Hoffmann was insouciant about this. He thought that the trust would not be attractive to investors because they could not enforce it in practice until the end of the restriction period. He said that there was no evidence that anyone but family members was willing to advance money to HOS buyers in the expectation of acquiring an interest in the property.²⁰ The evidence of which his lordship spoke was the cases in which a claim to a beneficial interest in HOS property had reached court. All those cases were claims by family members.²¹

This analysis is, with respect, rather too sanguine. It assumes that commercial exploitation of the trust device would be limited to those who wish only to speculate upon a rise in the value of HOS flats during the restriction period. In consoling himself that the risk of exploitation was remote, Lord Hoffmann whilst acknowledging the commercial ingenuity of the people of Hong Kong said “I should imagine that if there were money to be made in subscribing the purchase price of HOS flats, someone would by now have started such a business”.

The native ingenuity of Hong Kong business has indeed found a way of making money from HOS flats, although not by joining in the purchase of them. Naturally, family members who advance money to successful HOS applicants are primarily interested in helping another member of the family to secure a place in which to live. They may wish to acquire a stake in the property and eventually to realise it as well but their motivation is hardly commercial. Equally, investors, in the sense of those who speculate on an increase in the value of a property and look to resale as the sole means of realising their gain, are unlikely to be willing to wait five years. However, there is another commercial operator who is willing to wait until the end of the restriction period and is already exploiting, quite legally, the financial potential of HOS property and who is not mentioned in Lord Hoffmann’s analysis: the money lender, finance company or “loan shark”.

Such operators openly advertise in Chinese newspapers the availability of “second mortgages” to HOS owners. Contrary to Lord Hoffman’s assertion, there is plenty of evidence that lenders are willing to invest in

²⁰ *Ibid.*, [32].

²¹ *Wong Lai Suk Chum v Wong Chiu Ming* [1993] 1 HKC 522; *Fan Siu Ngan v Yeung Kin Yip* (unrep., HCA 10488/1997, [2001] HKEC 364); *Re Chow Man Kwong, ex p Chow Man Kwong* [2000] HKLRD 482; *Leung Chi Man v Mok Sau Lim* (unrep., HCMP 1599/2003, [2005] HKEC 456); *Lee Tso Fong v Kwok Wai Sun* [2008] 4 HKLRD 270.

HOS property. True, little of the evidence is in the form of legal disputes and decisions – why would it be, since to their mutual benefit both the lender and the borrower wish to proceed with the loan and to conceal it from the party who might want to prevent it, the government? There are in fact a few decisions, understandably not drawn to the attention of the CFA, in which the involvement of moneylenders in relation to HOS property is mentioned.²² However, the main evidence is the existence of offers and schemes to assist HOS owners. Perhaps, the Court of Appeal was in this respect better informed than the CFA.

Finance companies are only too pleased to help an HOS purchaser to turn the difference between the value of the flat and the amount paid for it into ready cash. The fact that they have to wait until the end of the restriction period to look to the property for repayment of the loan is not a deterrent, for in the meantime the loan repayments, including ample interest, are being made or, if not being made, are accumulating eventually to be met out of the value of the property.

HOS purchasers are by definition people of restricted means and therefore prone to be in need of extra money. The fact that they own a flat, a valuable and generally appreciating asset, sets them apart from others in their stratum of society and makes them an attractive risk for lenders. The fact that part of the value of the flat is in effect a gift from the government makes the risk all the more attractive. There have long been finance companies which specialise in making personal loans to HOS owners. Occasionally, those companies become approved replacement mortgagees for the original government-approved lender, since on proof of financial hardship an HOS owner can be given permission by the Housing Authority to enter into a substitute mortgage or charge as security for a larger loan.²³ More often, however, the finance company does not replace the approved mortgagee and simply advances an additional loan to the owner who wishes to have more spending money. This loan cannot be secured by mortgage or charge over the flat. Lawyers for these companies have devised complex sets of documents which give their clients security for their loan. The documents do not include a mortgage or charge over the property, at least not expressly, for that would fall foul of s 17B. Instead, the security is over the proceeds of sale of the property.

²² In *Lin Kam Chang v Chak Kwok Wing* (unrep., HCMP 3540/2000, [2001] HKEC 1247) a loan agreement made by the vendor-owner of an HOS flat which was referred to in the land search record was held not to affect the title to the flat and in *Konew Finance Ltd v Wong Kai Ming* [2001] 4 HKC 218 the lender had kept the deeds to an HOS flat as security for a loan.

²³ Mortgage brokers, some associated with finance companies, introduce borrower to lender for a percentage of the amount of the new loan.

The documents which achieve this include a loan agreement, a promissory note, a guarantee, a release, a power of attorney, and pre-signed letters and notices. Apart from the usual covenant for repayment, the loan agreement contains an assignment by the owner-borrower to the lender of the net proceeds of sale (after payment of the premium to the Housing Authority and of any approved mortgage loan) of the property by the owner. The agreement also contains authorisation by the owner allowing the lender to obtain credit information about the borrower (from the approved mortgagee, for instance) and a covenant by the owner not to deal with the land before the debt to the lender has been settled. The power of attorney authorises the lender to receive and give a good receipt for the balance of the purchase price on behalf of the owner. Letters and notices signed by the owner and given to the lender direct the owner's conveyancing solicitors, the mortgagee bank and the purchaser to pay to the lender the sums which are due to the borrower in the sale.

The position of the lender may be reinforced by deposit of the title deeds with the lender.²⁴ If the owner asks for return of the deeds, the lender will be alerted to the possibility that the owner has entered into some sale or other transaction concerning the land. In an effort to prevent the deposit from amounting to or evidencing a mortgage over the land, the lender is declared to hold the deeds as custodian only and subject to a right of return to the borrower. Some lenders try to secure themselves further by attempting to register the loan agreement at the Land Registry, the ostensible reason for doing this being to warn searchers such as a potential purchaser from the owner of the lender's rights, but since those rights are over the proceeds of sale and not over the land, the document does not affect land and is strictly not capable of registration.²⁵

If the owner defaults on repaying the loan, the lender can obtain money judgment and then wait until the end of the restriction period to register a charging order against the property. During that period, the property cannot be charged as security for the loan but neither is the owner able to sell the property.²⁶ After expiry of the period, the lender keeps a keen eye open for any attempt by the borrower to sell the property so that the lender can recoup the debt from the proceeds of sale.

²⁴ *Konew Finance Ltd* (n 22 above).

²⁵ Which probably explains why the agreement granting a loan to an HOS owner was placed in the "deeds pending registration" section of the land search record in *Lin Kam Chang* (n 22 above): the registrar must have held doubts as to whether the agreement affected the land as required by *Anstalt Nybro v Hong Kong Resort Co Ltd* [1978] HKLR 414.

²⁶ Except with permission of the Housing Authority which will require that the owner repay the subsidy making the sale an unattractive option for the owner compared with a sale after the end of the restriction period.

The lender itself may enforce the charging order by judicial order for sale of the property.

This elaborate process of securing repayment of a loan to an HOS owner whilst studiously avoiding any suggestion of taking an interest in the property has now become unnecessary. The one disadvantage suffered by those who lend to owners of HOS flats is that they cannot secure the loan by charge or mortgage over the property: the security would be rendered void by s 17B and would be punishable under s 27A. That disadvantage has been removed in effect by the CFA's decision in these appeals. All the lender has to do is to have its lawyers draw up a deed of trust for execution by the owner-borrower simultaneously with the loan agreement. The lender will then acquire a beneficial interest in the property which can serve as security for repayment. This can be done soon after the owner has acquired the HOS flat so that the lender becomes in practice an investor in the property almost from the outset. Indeed, there is nothing to prevent the lender from advancing a personal loan to an HOS purchaser for the acquisition costs of the flat simultaneously with the execution (perhaps in escrow) of the declaration of trust.

According to the CFA, this arrangement would not be an alienation (at least not one within s 17B), it is the creation of a derivative interest. But may it not be both? The registered owner of the flat has the legal and equitable interest in the flat. In making an express declaration of trust, the owner may be said to be creating a derivative interest out of the legal interest but the owner may also be said to be transferring the equitable interest to the beneficiary. It is a voluntary disposal of property to another: in other words, an alienation. However, the CFA has now told us that this is not so. It is not an alienation within s 17B where the person advancing the money is a member of the family. Nor is it such an alienation where the money is advanced by an investor, speculator or lender.

